COMMERCIAL UPDATE - SAKHALIN REGION, Nov.-Dec. 2005

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Sakhalin–1

** Exxon may have to look to Shell for assistance*
ExxonMobil may have to consider carrying gas from its Sakhalin-1 development project on the Russian Pacific shelf for liquefaction to competing Shell-led Sakhalin-2 LNG project. Exxon is looking to transport gas via a pipeline to China, but Sakhalin Governor Ivan Malakhov said recently Sakhalin-1 cannot produce enough gas to make this viable.

Sakhalin-1 is expected to have a capacity of 11 billion cubic meters annually, of which 8 Bcm would be available for export. But Russia says this figure is too small to justify constructing a new pipeline infrastructure, for which it would have to reimburse costs out of its share of production. Backing the LNG option is India's Oil and Natural Gas Corp., which holds a 20 percent share in Sakhalin-1. The move would allow it to swap the LNG for gas supplies from countries closer to India. ONGC and Exxon are holding talks to assess buying Sakhalin-1's entire gas output. The two firms have also approached Shell about using its Sakhalin-2 facilities, but Exxon's Sakhalin chief remains adamant about the pipeline exports and believes output from neighboring Sakhalin projects could make it happen.

Sakhalin-2

**Sakhalin fishermen urge EBRD not to fund Sakhalin-2 project (RIA Novosti, October 17, 2005)*

A group of fishing companies operating off Russia's Far Eastern coast where the Sakhalin-2 international oil and natural gas project is under way, have asked the European Bank for Reconstruction and Development (EBRD) not to fund the project's second phase, the companies' lawyer said Monday. "We have sent a letter to the EBRD demanding that it should not support the project," said Alexei Tyndik, the lawyer of the Kalipso and Kontrakt companies and the Korsakovsky fish cannery. The companies said the construction had had an adverse environmental effect on the region and the volume of fish caught. He said the bank was expected to make a provisional decision on the issue in the next 45 days.

Ivan Chernikhovsky, a Sakhalin Energy spokesman in Moscow, said the company was intent on reaching a mutually beneficial agreement with the fishing companies, and that oil terminal construction had not had a considerably hazardous environmental effect. The EBRD and Sakhalin Energy were working together to settle numerous environmental issues, a very time-consuming process.

** Sakhalin Energy set to increase production volume. (RIA Novosti, November 1, 2005)*

LNG Plant in Prigorodnoye, Sakhalin (By unknown author)

Sakhalin Energy (Sakhalin II Project) is planning to significantly increase the production volume in 2005, according to a company official. "We have already produced 10 million barrels and I think we will exceed the planned production volume of 12 million this year," head of the company's Moscow representation office Viktor Snegir said during the 5th All-Russian Oil and Gas Week. According to Snegir, the company has produced 9.5 million tons of oil since 1999 and is planning to start yearlong production in 2007.

** Shell Sakhalin-2 Plans (Bloomberg)*

Shell plans to expand production of liquefied natural gas at its Sakhalin-2 project, the Financial Times reported, citing Sakhalin Energy Investment chief executive Ian Craig. Shell says it could adjust the plant in two stages to increase production by as much as 20 percent and may add one or more LNG production lines, known as trains, to its Russian-based project. "It's highly likely there will be at least a third train and more," the Financial Times cited Craig as saying. Sakhalin Island has an estimated 45 billion barrels of oil and gas reserves, Craig has said.

**Shell raises 2006 investment budget. (Reuters)*

Royal Dutch Shell Plc will have to invest USD 4 billion more than previously planned in the coming year, as costs soar and the company tries to turn around its industry-lagging record on finding oil.

Anglo-Dutch Shell, the world's third largest listed oil company by market capitalization, said yesterday its capital investment budget for 2006 would be USD 19 billion, compared with earlier plans of around USD 15 billion. Shell said in July that its medium-term guidance for capital expenditure of USD 15 billion a year after 2005 was no longer valid and analysts expected the company to raise its budget to between USD 17 billion and USD 20 billion a year. Shell said in a statement that USD 15 billion would be invested upstream, including USD 2 billion for exploration, and that USD 4 billion would be invested in downstream activities, where tightness in refining capacity has helped send oil prices to record highs.

The company said the USD 15 billion upstream budget excluded its minority share of Sakhalin, a large oil and gas project off Russia's east coast where costs have doubled to USD 20 billion. Shell has agreed in principle to sell part of its 55% stake in the project to Russia's Gazprom. About 25% of the increase in upstream capital investment next year relative to 2005 was due to price inflation, Shell said.

Shell Changes Its Russian Head (Kommersant, November 18, 2005)

John Barry, who has been Shell's Country Chairman in Russia for three years, is leaving the position to become the company's vice president for oil production from unconventional resources and development of oil recovery technologies.

Picture By Kommersant

Speaking about Shell's suggestions to raise the estimate of expenditures to $20 billion from $12 billion for the Sakhalin-2 project, Mr. Barry said that once they had started extracting on the Sakhalin shelf it became evident that expenditures had to be increased. Mr. Barry also mentioned external reasons for the rise such as general price hikes on the raw materials market. "Sakhalin-2 is a long-term project, therefore changes during its implemented has a great effect on expenses." Mr. Barry also breached the subject of the exchange of 50-percent stake in Sakhalin-2 with Gazprom for the Zapolyarnoye-neokom company in connection with the rise in expenses. He said the company had to announce an increase in expenses on Sakhalin-2 a week after they had signed the memorandum of agreement with Gazprom since rules on the disclosure of information on international stock exchanges bound them to. Under the agreement with Gazprom, Shell is now to check the assets to be exchanged. John Barry did not rule out Shell's participation in other projects in Russia and called the Western Siberia a very promising region.

Rosneft-SMNG

Picture By Dalbnevostochny Kapital Magazine

** Rosneft-SMNG appoints new General Director (Article by SOGN; Gubernskije Vedomosti, October 4, 2005)*

On September 29, JSC Rosneft-Sakhalinmorneftegas Board of Directors headed by Sergei Bogdanchikov, its President, appointed Viktor Lyubushkin as the new General Director of the JSC. While presenting the new General Director, Mr. Bogdanchikov mentioned that Lyubushkin was the very first from Rosneft's subsidiary General Directors to be appointed as a result of passing through a complicated system of different tests that define both the professional and personal qualities of candidates.

Sakhalin-6

** Urals Energy completes second development well (Sharecast.com, October 21, 2005)*

Oil explorer Urals Energy received a welcome boost after announcing the completion of its second development well in Russia and details of next month's offshore exploration drilling program. Russian subsidiary Petrosakh is currently producing 2,800 bopd *(barrels of oil per day)* from 16 wells in the Okruzhnoye Field at Sakhalin, with a 14 well development drilling program targeting increased production of around 5,800 bopd.

The second well, Well 44, has now been completed and is producing at a stabilized rate of approximately 660 bopd on a 13mm choke with 4% water cut, said Urals. The first well is flowing at a sustained rate of 360 bopd, in line with the 350 bopd projected for each new development well, while well 44 "significantly" exceeds this. Drilling of a further 12 development wells on this field is scheduled to start in the second quarter of 2006. Chief executive William Thomas said, "These development drilling results are significantly ahead of expectations and should boost production by about 1,000 bopd allowing us to benefit from attractive commodity prices." Urals also announced the drilling of its first offshore exploration well to test the Pogranichny Block, East Okruzhnoye No. 1, scheduled to begin by early November, a month earlier than planned. Experts estimate this prospect to contain potential resources of about 50m barrels, while the Vitnitskaya and the Severo Rymnikskaya prospects offshore Sakhalin Island are estimated to have combined potential resources of approximately 247m barrels.

Contracts

** Emerson awarded major Sakhalin II contracts (Press release by Emerson Process Management; November 9, 2005)*

Emerson Process Management has supplied over 1500 Rosemount pressure and temperature transmitters for use in the Sakhalin-2 project.

London-based AMEC, the main contractor for the offshore platform production control systems, selected high reliability Rosemount pressure and temperature instrumentation from Emerson to meet the specification for both Phase 2 platforms, the Lunskoye platform LUN-A and the Piltun Astokhskoye PA-B platform. Approximately 500 Rosemount pressure transmitters are being supplied, some with chemical seals and some with integral manifolds. Most of the 350 Rosemount temperature transmitter assemblies will be supplied complete with special Shell-designed thermowells.

Full press release can be found at http://www.emersonprocess.com/home/news/pr/511_sakhalin.html

** Hyundai Builds 3 Oil Tankers for Sakhalin-1 Oil and Gas Project Worth $150M (Moscow News, Nov. 11, 2005)*

Photo from www.ship-technology.com at Mosnews

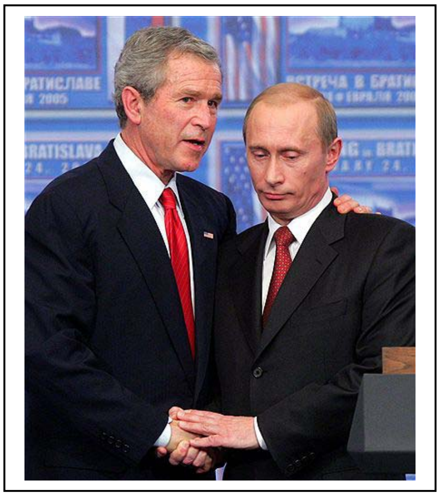
Construction of three oil tankers with tonnage of 100,000 tons each was finished at the Hyundai Heavy Industries shipyard in South Korea. The naming ceremony after which the tankers, whose total costs amounts to $150 million, were delivered to the customer took place on Monday, Nov. 21.

The tankers were ordered by Sovcomflot, Russia's largest shipping company. The president of the shipping company Sergei Frank said that the tankers were designed and built specifically for transportation of oil within the framework of Sakhalin-1 oil and gas project, which is a large source of foreign investments in the Russian economy. Two of the tankers will be used for transportation of oil from this production site, while the third one will be used for transporting oil from the port of Primorsk, built in 2001 at the Baltic Sea shore.

Hyundai Heavy Industries has already constructed about 40 tankers on orders from Sovcomflot. The South Korean company was established in 1972.

** Bush asks Russia to clarify new mineral plan (Reuters and Washington Post, October 24, 2005)*

The Bush administration called on the Kremlin to clarify a proposed law that would limit foreign firms' access to some of Russia's prize crude oil and natural gas deposits and minerals. "Our government would like to see the passage of the Russian subsoil law, which will clarify the rules and the laws for investment in the energy area," U.S. Energy Secretary Sam Bodman told reporters after meeting with Russian Energy Minister Victor Khristenko and top Russian energy executives. President Vladimir Putin called on his government earlier this year to tighten the state's grip over strategic resources like oil and natural gas deposits. Khristenko pointed out that it would only apply to a handful of large fields where foreign investors are not seeing majority stakes. Analysts say BP could be the main victim of Russia's forthcoming law on subsoil use, which would bar firms that are not majority Russian-owned from bidding for certain strategic energy deposits.



Picture by Kommersant

The ministry wants to ban foreign firms from fields with more than 1 billion barrels of oil or 1 trillion cubic meters of natural gas. Large remote offshore fields could still be developed by foreign ventures. The rule could apply to many of Russia's prize natural assets, including a list of oilfields in the Barents Sea, the Timan-Pechora and Yamal-Nenets regions, and the Sakhalin-3 project in the Far East. Khristenko also hinted that the Russian government is leaning toward choosing a U.S. partner for a consortium to develop the $20 billion Shtokman field in the ice-covered Barents Sea.